

TUCSON SUPPLEMENTAL RETIREMENT SYSTEM BOARD OF TRUSTEES

Meeting Minutes for August 27, 2009, 8:30 a.m.

- Members Present:** Brian Bjorndahl, Chairman
Kevin Larson, City Manager Appointee
Cindy Bezaury, Human Resources Director
Silvia Amparano, Interim Finance Director
Brandy Kadous, Employee Representative
Gage Andrews, Employee Representative
Jean Wilkins, Retiree Representative
- Staff Present:** David Deibel, Board Counsel
Allan Bentkowski, Investment Manager
John Behrens, Finance Analyst, Investments
Mike Hermanson, Retirement & Benefits Administrator
Doris Rentschler, Finance Analyst, Retirement
Claire Beaubien, Board Administrative Assistant
Jenefer Carlin, CTRA Representative
- Guests Present:** Helen Gutridge, Disability Retirement Applicant
John Thomas, Employee
Ken Brooks, T. Rowe Price
John O'Hare, Employee
Rob Van den Brink, Hewitt Investment Group
Mark Klimek, Hewitt Investment Group
Vittorio Lacagnina, SteelRiver, IFNA
Dennis Mahoney, SteelRiver, IFNA
Chris Harris, Macquarie
Steve Gross, Macquarie
Gordon Kaiser, Friess Associates
Bill D'Alonzo, Friess Associates

A. Call to order

Acting Chairman Andrews called the meeting to order at 8:30 a.m., after determining that a quorum of Board members was present.

B. Consent Agenda

1. Approval of July 23rd Board meeting minutes
2. Retirement ratifications for the month of August 2009

Jean Wilkins **moved, seconded** by Silvia Amparano, to approve the Consent Agenda as presented. **Motion passed 6 to 0** (Brian Bjorndahl, absent at time of vote).

C. Amendments to Tucson Code sections the provide death benefits to member designated beneficiaries in the event they are eligible to retire and die while employed

Mike Hermanson distributed final versions of the Mayor & Council communication and ordinance proposing amendments to related sections of the City code to the Board members. Mike indicated that the Mayor & Council Communication had been tweaked from the prior version indicate actions taken by the board in following Mayor & Council direction to seek out solutions and consensus with employees. Attached to the communication was a copy of the All City communication regarding the proposed changes and a matrix to provide concise illustrations of how death benefits are paid to beneficiaries of TSRS members as discussed at the July board meeting. Mike indicated that no negative comments had been received following distribution of

the Citywide email and one thank you note from an employee stating their appreciation of the time and effort expended by staff and the Board on this issue.

Gage asked Mike to walk the Board through the changes made from the prior draft. 1st, the ordinance provides clearer definition to who the "legal or personal representative" can be for Section 22-30(u). In Section 22-33(f), clarification is added to emphasize the responsibility for designating beneficiaries is that of the member; and if the member fails to update the designation of beneficiary form on file, the form on file at the time of death is used for beneficiary purposes; a change in marital status also does not impact the enforceability of a beneficiary designation. Section 22-40(e), sections 1-4 state the default provisions taking effect retroactively to July 1st, which are dependent upon whom the member designates as beneficiary as summarized in the matrix included with the ordinance changes. Finally, Section 22-42(a) states that the benefit election made at the time of retirement is irrevocable once the retirement is ratified by the Board and Section 22-42(e) indicates that benefit elections becomes effective when a member dies while eligible but prior to board ratification to tighten both of those provisions up.

Jean Wilkins asked Mike if the Retirement Office intended to remind the members to update their beneficiaries on an annual basis. Mike responded that the Retirement Office plans on launching a campaign that reaches out to the entire active and deferred membership to encourage these employees to update their beneficiaries or to check the beneficiaries selected. These updated designations will be completed on new forms that mirror the spirit of the new ordinance. Once this campaign is completed, future campaigns could be accomplished every five years to keep records up to date. Doris Rentschler commented that the new Annual Statement that the new pension software is capable of generating will include beneficiaries which should remind people to change or update their beneficiaries. The amendment is scheduled on the Mayor & Council Consent agenda for September 9th. John Thomas commented that he and Janet Nickell reached out to their network of employees to compliment the Board for their work on this matter and they plan to do the same to communicate their support to the Mayor and council on the amendments being proposed. John requested and was provided a copy of the draft ordinance. Brandy Kadous **moved, seconded** by Jean Wilkins, to accept the amendments to Chapter 22 of the Tucson Code as provided in the subject of the Mayor & Council Communication and recommend approval of same. **Motion passed 6 to 0** (Brian Bjorndahl absent at time of vote).

Note: consideration of agenda item D was delayed until after items E, F and G were completed. Prior to discussion of item D, Chairman Brian Bjorndahl arrived, so the full board was present for discussion.

D. Disability Applications*

1. Helen Gutridge (returned to consider vote before entire board)

Brandy Kadous **moved, seconded** by Silvia Amparano, to move in to Executive Session. **Motion passed 7 to 0 at 10:04 a.m.** Cindy Bezaury **moved, seconded** by Jean Wilkins, to move into Regular Session. **Motion passed 7 to 0 at 10:24 a.m.** Brian Bjorndahl **moved, seconded** by Jean Wilkins, to approved the Disability Retirement for Helen Gutridge. **Motion passed 4 to 3 by roll call vote.**

E. Investment Activity / Status Report

1. Portfolio composition, transactions and performance

Allan Bentkowski began by reporting the TSRS portfolio balance was \$507 million at July 31st, up from the prior month end at \$484 million and currently stands at \$520 million on 8/26/09. That balance is net of the \$1.6m transfer out from the PIMCO Fixed Income Custom account to the City's investment pool account to meet ongoing pension payment obligations. Allan reported that as of 7/31/09 all managers were within their target allocation ranges. Equity managers are beginning to pull closer to their policy allocation targets.

The portfolio has posted good absolute returns in July from all managers, except Real Estate, producing positive returns. Overall, this is the best beginning of a fiscal year in the past two years. Calendar year-to-date returns were positive across the board except for Real Estate and Infrastructure. Both Fixed Income

managers and six of nine equity managers outperformed their respective benchmarks. PIMCO StocksPlus and Pyramis posted very good returns. TCW Value and Causeway posted solid returns while Friess and Artio posted poor returns. Allan turned the meeting over to Rob Van den Brink and Mark Klimek from Hewitt Investment Group for a more comprehensive report on the fund performance.

F. Hewitt & Associates presentation of June 30, 2009 Prime Report

Rob Van Den Brink passed out an update to the June Prime report thru close of Friday, August 21st, commented that the first thing visible in the update was Emerging Markets demonstrating they are far and away the leader in the market recovery with YTD returns at 51.79%. Last year, emerging markets was the worst place to be in, all the way to the first few months of 2009. However, emerging markets are taking off and have outdistanced other sectors. Artio trimmed back their positions in emerging markets considerably and are now suffering due to the rebound made by emerging markets. High yield has now started to bounce back. Rob remarked that in general, growth has done better than value in the equity markets.

Commercial real estate values are now turning downward and become a concern. Last year, residential real estate performed poorly. The public REIT market fell last year and this is an indicator of what will happen on the private side, where private real estate portfolios are declining. REIT's have rallied significantly this year which could indicate that the bottom is near in commercial real estate. There is relatively weak consumer demand, which has a negative effect on retail properties. Continued unemployment approaching double digits will negatively impact office properties. Goods need to be stored and industrial properties have fallen, as well. There is more leverage in the portfolio and that dramatically affects the performance on the upside as well as the downside.

Rob indicated that the markets are showing positive results. Although the GDP is rising, the unemployment rate is also rising, and consumer discretionary spending has decreased. Inventory has decreased significantly. At some point, inventory will have to increase and this, in turn should create jobs. Many of the banks have paid back the TARP money such as JPMorgan, Goldman Sachs, Morgan Stanley and American Express. It appears that that aspect of the stimulus package has been a success.

Consumer discretionary (retailers, restaurants) was one of the places to in the 2nd Qtr. for good performance. Yet, surprisingly, the best place to be was with certain stocks that were under \$5/share, with negative or no earnings and no expectations for earnings growth. Financials is another sector that has rallied mightily this year. Last year, Financials was the worst place to be but if you didn't invest in financials this year, you would not have done well. Fannie Mae and Freddie Mac are rallying significantly. Technology and materials (raw) are rallying surprising the experts.

Mark Klimek reported that PIMCO StocksPlus has rallied more than most of the other managers. While PIMCO StocksPlus struggled previously, they are now more than 10% above their benchmark with a year-to-date return of 25.93%. What hurt them last year is what is helping this year. They were and still are overweight in high quality mortgage, asset back securities, corporate securities, financial credits did really well. This manager bets heavily on the shape the yield curve is going to be. PIMCO Custom Fixed Income also did well with nearly 5% over their benchmark. They, too, invested in high quality mortgages and high yield. Mark reported that the Barclays Russell 1000 Alpha Tilts product was lagging the benchmark slightly. Rob and Mark had the opportunity to meet with these managers and are not convinced that now is the time to pull them out of the portfolio. Hewitt downgraded them to a Neutral rating based on their poor performance and the fact that they were purchased by BlackRock. Whenever ownership changes hands, it is sometimes difficult for the employees to keep focusing on the business at hand. Mark believes this is still a good product but if they don't outperform this year, it might be to the Board's best interest to think about replacing them. Rob remarked that quantitative manager looks for anomalies in the market but there haven't been many anomalies to support their way of doing business. Rob commented that quantitative managers tend to do better when there are trends but there have been sharp reversals in the past few years which caused their poor performance. Gage asked if the potential correction to the excessive optimism in the market will be in favor of a quantitative manager or against a quantitative manager. Rob replied that it depended on where the

correction comes from. If it comes from stocks that have run very quickly and stocks that are high quality, they will do better.

Mark commented that part of what has hurt Friess is that they tend to invest in higher quality companies. Friess has also had some stock selection errors. They look for catalysts and what has a potential to drive the company to success. Friess also had exposure to Safeway and stores similar to Safeway which did well until the market rally. Hewitt is moderately favorable in regards to this manager. Friess has not lost many clients during this period of underperformance.

Fidelity Small Cap and TCW Value have outperformed their respective benchmarks significantly and posted returns that are up nearly 20%. Their stock selection was the prime reason for their outperformance.

Mark reported that Causeway reviewed their position in February and changed their position in the hopes of an expansion in the market place overseas. This has obviously been the right move because they have outperformed their benchmark year-to-date. Artio, on the other hand, has had the reverse reaction. Artio positioned their portfolio defensively. They did not envision the rebound by the financial sector. They expected that there would be no recovery in emerging markets. Their exposure to emerging markets was 7%. Their financial exposure was nearly zero. Those two exposures caused their underperformance. They have since changed their weighting in these sectors and are now outperforming in the 3rd quarter. Mark suggested that Artio be invited to present at the October retreat. This will give them an opportunity to explain what happened and how are correcting it.

Rob reported that, although JPMorgan Strategic Property posted a -18.5% performance for the first half of the year, they have done better than most other real estate managers have done in the same period. JPMorgan doesn't have a lot of leverage of loans that are coming do. They are holding extra cash than they normally do in case that they need to pay off some of their properties. JPMorgan Income & Growth is leveraged at 60% so anything that goes down is magnified. They are very well leased by their underlying properties. They are holding even more cash than the Core fund. Hewitt believes JPMorgan is one of the best real estate managers in the U.S.

G. Annual Investment Manager Reviews

1. SteelRiver, IFNA – Vittorio Lacagnina & Dennis Mahoney

SteelRiver acquired from B&B the general partner interest of the Infrastructure Fund of North America (the Fund). John Hancock acquired B&B's limited partner interest in the Fund. SteelRiver partnered with John Hancock Life Insurance Company, an existing Limited Partner of the Fund, to execute a management buyout of B&B's LP and GP interest in the Fund. The transaction closed May 15, 2009. John Hancock does not have control over anything that the Management Team does. They were supportive in providing financing for the buyout.

Dennis Mahoney, Senior Managing Partner, reported that SteelRiver has 34 people staffing the management team. There are three senior partners that have over 70 years of experience combined. By divorcing themselves from Babcock & Brown, they have eliminated the potential conflicts of interest.

SteelRiver invests in core infrastructure assets for the long term, seeking investments in businesses that provide essential services necessary for human existence with stable cash flows and monopolistic, often regulated, characteristics. SteelRiver Infrastructure Fund North America (SRIFNA) is a \$1.9 billion unlisted infrastructure fund with a 20 year term managed by SteelRiver that owns and manages energy and infrastructure assets throughout North America.

Vittorio Lacagnina, Director, reported that the Fund is a long term fund that put them in line with the limited partners. There is a three year investment period. The Fund closed on October 22, 2008. Their target sectors include gas and electricity, transport, rail, water, ports and other concession based assets. Allan asked if there will be a capital call later this year. Dennis responded that there will be another capital call in

late November. Mark asked if they have seen the stimulus money competing with their fund raising. Dennis replied that they have not seen any stimulus money competing with them in any way.

Vittorio said that Natural Gas Pipeline Co. of America (NGPL) is one of the largest domestic natural gas pipelines and storage systems traversing 10 states in the central U.S. There are over 10,000 miles of gas transmission pipelines and over 250 billion cubic feet of integrated storage supplying approximately 61% of all gas delivered in to Chicago and Northern Indiana markets.

The rationale for acquiring this company included that it is in a strategic location with significant barriers to entry to new competitors for both supply and storage. Also, this company provides over 60% of the natural gas supplies to the Midwest Chicago market. NGPL is one of the largest storage operators in North America with over 250 billion cubic feet of natural gas storage. NGPL exceed the 2008 calendar year and 2009 FY financial and operating goals. The current 2009 forecasts expected to exceed 2008 results as well as the 2009 plan. They continue to enjoy a stable and favorable regulatory environment.

Dennis spoke about another asset they have acquired called Trans Bay Cable (TBC). TBC is a 53 mile long 400 megawatt, high voltage direct current land and submarine-based electrical transmission cable designed to deliver electricity to San Francisco across the San Francisco bay. Vittorio explained TBC is a vital component of San Francisco's electricity supply, delivering approximately 40% of the city's electricity needs and significantly reducing regional grid congestion. They are currently under construction pursuant to a fixed-price engineering, procurement and construction contract. The project is currently on schedule for Commercial Operations March 2010. A major rationale for acquiring TBC is it is recognized by the Federal Energy Regulatory Commission as a project to receive enhanced returns as a model electric transmission project.

Originally this fund was planning to spend 1/3 of the fund on energy, 1/3 on transportation and 1/3 on water. However, opportunities have not presented themselves for transportation. They will have some transportation but most of the fund will be invested in energy.

2. Macquarie (MEIF3) – Chris Harris & Steve Gross

Chris Harris reported that Macquarie was pleased for the opportunity to discuss their performance with the Board. He turned the presentation over to his colleague, Steve Gross, who reported that Macquarie was very sound financially. Macquarie has a sound balance sheet and the fund that TSRS is in is doing well. Very few people are leaving the organization. This fund owns two airports in Europe that have a lot of opportunity for growth. These airports are regulated business which means that the regulator steps in when there are disputes with the airlines so there downside protection. Even when traffic diminishes, the earnings continue to hold up. Steve pointed out that these airports make up a large part of the fund. He said there are fantastic opportunities in Europe that will generate cash flow at a fairly early stage. The bulk of the economy in Europe is socialist and is inefficient in the market. Because of this, Macquarie doesn't have to pay full price for a company.

Steve commented that it was likely that Macquarie would be investing in a European utility company in the 4th quarter of 2009. The utility company will generate cash flow early in the relationship and they won't have to pay full price for this company.

Steve remarked that their fundraising wasn't progressing at the rate they had anticipated after they made these investments. Then, the fiasco with Lehman Brothers happened, the equity market tanked and the denominator effect (pension plans that allocations to infrastructure could no longer retain those allocations) took place. A \$6 billion pipeline of investors quickly became only \$2 billion. Because their fundraising hasn't progressed as fast as they expected, they put in place an incentive to entice new investors while compensating current investors with a fee rebate for two years. This has produced an amount of interest in the fund and the pipeline has risen to \$3 billion.

Allan asked when their next capital call would be so he can plan for it. Steve responded that it would likely be in the 4th quarter of 2009, close to the end of the year. He said they are focused on buying three businesses at the moment. They are focusing on utilities instead of airports because 1) they already have enough airports and they are exposed to duty fees and 2) utilities have an inherent link to revenues against inflation. The three businesses they are interested in are EDF, an energy company in the U.K.; a gas distribution grid in Germany and a gas distribution grid in Spain. All of these businesses offer protection from inflation, cash flow at an early stage and will offset the management fee.

Steven reviewed their various acquisitions and the reason they invested in them. The first property reviewed was the Brussels Airport which has dual till regulatory framework providing core business protection with commercial upside. This business operates under a regulatory regime with charges agreed with the airlines until 2011. Macquarie negotiated a 4 – 5% increase to protect the revenues. So, if the airline revenues go down, Macquarie can charge them more but if the revenues go up, Macquarie has to charge them less. Brussels is in the heart of Europe and serves as “the political capital of Europe” which hosts all major EU institutions as well as NATO and other international organizations.

Copenhagen is the second airport owned by Macquarie. It is the largest airport in Scandinavia with a total terminal capacity of around 30 million passengers per annum across its three passenger terminals. There were a number of initiatives that were put in place before they bought the airport. These initiatives would encourage people to spend more at the airport because of the duty free status, and now has 25% more retail space.

Rob asked Steve when they were last audited. Steve replied that they were audited in March by Price Waterhouse. He said that Price Waterhouse does the auditing in two stages: The first stage looks at the process of value and looks at their checks and balances and approves or disapproves. The next stage is they look at the value of the business to see if it has been impaired, i.e. has the value of the business gone below what was paid for it. Rob asked how the value of the business could possibly be higher than when you bought it. Chris responded that was because they bought it right. Steven added that the value of the businesses was 10% higher than what Macquarie bought them for. So, the value had already come down and the price paid for the business was lower than what it had been previously. Chris remarked that with one of the airports they bought, they knew that one of the airlines was leaving so they were able to fill that slot quicker than anticipated. However, that assumption was built into the projection going into the acquisition.

Macquarie only invests in things that are essential services, things that are used every day. They also invest in things that have stable and long term cash flows. They invest in businesses where the acquisition price is lower than all recent relevant comparables. Their core characteristics of infrastructure include being essential services, sustainable competitive advantage and stable and predictable cashflows.

Mark Klimek remarked that many of the Board members have read news articles recently regarding Macquarie. He asked Steve if he cared to respond to these queries. Steve responded that Macquarie is a solid and stable institution. In 1995, Macquarie became regulated as a bank so it became an Australian banking institution with a strong focus on risk management. Since the end of 2006, Macquarie has been very focused on shoring up their balance sheet by selectively selling businesses that weren't forming as they wanted and freeing up capital. In 2008, The Australian government offered guarantees to Australian banks and any deposits and any borrowings they may make. Consequently, Macquarie was able to borrow very cheaply. Steve remarked that he is comfortable that the institution will be viable for the next 30 years or more. Kevin Larson asked what the Board can expect in respect to returns in the next few years. Steve responded that he would hope that in terms of cash returns, 6% cash return would be reasonable and that could increase 7 – 9% over the following years. He said that long term total returns could go as high as 14%. Kevin asked Steven if they come back in five years and discover that the returns weren't as high as predicted, what would have gone wrong. Steve responded that the current weak economy would have gone on longer than anticipated. He said that a utility runs on accessing the debt market. If there is no debt market to access, then there would be a problem. Kevin asked what amount of leverage this fund has. Steve responded that at the fund level, they have no debt financing, but at the asset level they have 45% debt financing.

3. Friess Associates – Gordon Kaiser & Bill D'Alonzo

Gordon Kaiser remarked that their organization is really stable despite the machinations of the market. They have 72 employees of which 30 are dedicated researchers. They have had no research leader turnover since 2000. Assets under management are a little over \$9 billion. There have been no forced terminations. There have been no layoffs and no debt, they are in solid shape. From a philosophy perspective, nothing has changed in 35 years.

They invest in terrific companies before the market realizes the company's true value. Once the stock goes up, they then get out of that company and start the process over again. They do not rely on Wall Street, they don't rely on company management. They make over 100 calls to customers, competitors and suppliers per day. Bill D'Alonzo remarked that they can't always rely on the customers and competitors because they give the party line with little information. Therefore, they also talk to suppliers to the target companies or small companies who have "no axe to grind". As an example, Hewlett Packard has a small cap company working for them called Synex. Friess speaks to Synex every 6 to 8 weeks to help them determine how good Hewlett Packard is really doing.

Bill reported that they don't buy growth at any price. They don't buy companies with high leverage but have strong balance sheets. They identify companies with an earnings catalyst that is likely to exceed Wall Street estimates. They utilize the "forced displacement" discipline. Any stocks that have deteriorating fundamentals with price targets achieved will be forced out to allow room for a more favorable stock.

Gordon remarked that the biggest detractor in the portfolio was their consumer discretionary stock picks. Autozone was a good investment initially but people aren't able to afford the auto parts prices in the current economy. Theoretically, Autozone should be a good investment but it had disappointing returns. They are expected to rally this year with much better returns. Another disappointing investment was Apollo Group. When people lose their jobs, they tend to go back to school to learn new skills to enable them to secure a good job. Apollo was a natural choice due to the economy. Another area that was a real disappointment was Teva Pharmaceuticals. Teva is a large generic drug manufacturer. It was a laggard last year but has rebounded in 2009. Friess has increased their weight in Technology from 15% to 30% in the past quarter. Broadcom Corp is a major contributor to the portfolio due to iPhone, etc. One of the key drivers is some semiconductor chips for smart phones. Allan remarked that he can sympathize with Friess and their quandry with the stocks they hold that should be doing well but aren't. He asked Gordon and Bill what they do with these stocks considering how frustrating it must be that these stocks are not producing expected returns. He asked them if they just hold on to these stocks in the hopes that they will eventually rebound with an even better return or do they just dump them? Bill replied that as long as the companies they own are meeting their expectations of earnings growth and the P/E ratio stays within the level they can live with, they will stick with those companies. They have experienced times like this in the past and have rebounded even better than before.

Gage asked if there is one single factor that will indicate a change in the market. Bill responded that when some of the stocks that are going up for no reason start to fall, that would be a good indicator. However, he doesn't believe that the "recession" is over yet. There are still issues in the financial sector and the banking sector. There are significant mortgage obligations that will come due in the next five years along with the amount of Federal debt that is being taken on.

Rob and Mark commented that they are disappointed in Friess' performance but they believe that they will rebound and do not recommend that the Board replaces them. Rob commented that the two infrastructure managers gave good reports on their portfolios and are good, solid companies. The biggest issue with SteelRiver was the management turnover but he believes they are over that and are ready to move on. He said that SteelRiver is more diversified than Macquarie but Macquarie has a more solid management team. He believes they will both continue to do well for TSRS's portfolio.

H. Future Agenda Items

1. Consider Revised Disability Application – September
2. Review of Program Rules for Purchase of Service – September
3. Review of End of Service Program FAQ's – September
4. October Agenda Items – actuary report; PIMCO; Hewitt alternative investment discussion; Securities Lending; Artio Performance Review
5. Discussion of City Physician – September
6. Website references to TSRS in the Boards and Commissions area
7. IRS Application Update – September

I. Call to audience

None heard.

J. Adjournment

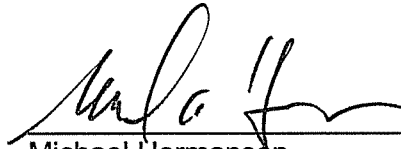
Cindy Bezaury **moved, seconded** by Jean Wilkins, to adjourn the meeting at 11:45am. **Motion passed 6 to 0** (Brian Bjorndahl absent at time of vote).

Approved:



Gage Andrews, Acting Chairman

9/23/09
Date



Michael Hermanson,
System Administrator

09.23.09
Date